Madison Gas and Electric Company
P.O. Box 1231
Madison, WI 53701-1231
608-252-7000

your community energy company

July 22, 2008

Via Electronic Regulatory Filing

Mr. Rorbert Norcross
Gas and Energy Division
Public Service Commission of Wisconsin
Post Office Box 7854
Madison, Wisconsin 53707-7854

Subject: MGE's Response to Survey Questions Dated June 3, 2008 - Docket 05-UI-114

Dear Mr. Norcross:

Attached are Madison Gas and Electric Company's comments to the survey questions in Commission's letter dated June 3, 2008, regarding innovative utility ratemaking approaches that promote conservation and efficiency programs by removing disincentives that may exist under current ratemaking policies.

If you have any questions, please call me at 252-7004.

Sincerely,

Paul A. Vanderbloemen

Paul A. Vanderbloemen
Executive Director -
Rates and Federal Regulations

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Attachment

Madison Gas and Electric Company

Response to Survey Questions Dated June 3, 2008

Docket 05-UI-114

Investigation on the Commission's Own Motion Regarding Innovative Utility Ratemaking Approaches that Promote Conservation and Efficiency Programs by Removing Disincentives that May Exist Under Current Ratemaking Policies

1. Do the current rate structures of the electric and gas utilities in Wisconsin contain net lost revenue and profit effect that is significant enough to discourage these utilities from developing and spending additional[1] money on energy efficiency programs?

MGE Response: No. The regulatory model currently used in Wisconsin eliminates much of the potential financial effects and disincentives. Additional improvements in the Wisconsin ratemaking process to address the issue would further mitigate any potential financial harm and reduce the perceived disincentive.

2. (Question for utilities) Is your utility likely to propose energy efficiency spending above current levels if any disincentive to do so is removed?

MGE Response: It depends on which disincentive is eliminated. Increased spending would require Commission review and inclusion in rates during a rate case proceeding prior to the initiation of the additional expenditures. If such expenditures are included in rates, a strong disincentive is removed.

If the question assumes financial disincentives caused by reduced sales volumes resulting from additional efficiency expenditures, MGE believes that such a financial disincentive is not the most important factor discouraging expanded spending on appropriate energy efficiency programs. Customer attitudes, market forces, rate impacts, customer impacts, regulatory treatment of the spending and the resultant effect on forecasted sales estimates and other factors will have a more significant effect on the willingness to propose expanded energy efficiency spending that has not been included in rates.

Further, new spending for program development could not and would not occur immediately. Program development could proceed on an expedited basis and still coincide with the existing ratemaking cycle in Wisconsin such that financial effects that could be considered to cause delay in implementation would be minimal, if any. For MGE, significant new program spending and development likely would not occur until 2010, which would coincide with MGE's next rate case test year under the existing rate case cycle. During that rate case, appropriate adjustments could be made to test-year cost and sales estimates to virtually eliminate any potential financial harm.

3. If disincentives are removed and the utility elects to spend higher than current amounts on energy efficiency, is it best for (a) the utility to develop and implement the programs, (b) should that be done by Focus on Energy, (c) should it be done through a combination of the utility and Focus on Energy, or (d) should it be done by some other entity?

MGE Response: In a related investigation (5-UI-115) the Commission will examine the possibility of significantly increasing the statewide energy conservation and energy efficiency programs that were last modified by 2005 Wisconsin Act 141. As part of that investigation we anticipate the Commission will refresh and expand the Energy Efficiency and Customer-Sited Renewable Energy: Achievable Potential study issued on behalf of the Governor's Task Force on Energy Efficiency and Renewables in

[1] The word "additional" is meant to refer to energy efficiency expenditures that are not otherwise required by law or by Commission order.

November 2005. The 5-UI-115 investigation, aided by an updated study of energy efficiency potential, will very likely demonstrate the importance of increasing our state's conservation and energy efficiency programs, the challenges of rapidly and steeply increasing spending through existing programs, and could also highlight areas where utilities are in a unique position to develop and implement effective programs. We think it is appropriate for the Commission to remain open to increasing conservation and energy efficiency programs by a combination of Focus on Energy and utility programs. Which entity develops and implements the program(s) would depend on the program being developed.

4. Do utilities currently have the resources to develop and implement additional energy efficiency programs?

MGE Response: No, but even if the resources were available, some significant lead time would be needed for development and implementation of additional programs.

5. Should a decoupling mechanism consider only the effects of additional energy efficiency spending or should it also include the effects of other factors such as the economy and weather on actual vs. forecasted sales? If yes, please explain why.

MGE Response: A decoupling mechanism should consider only the effects of additional energy efficiency spending. Such a mechanism would be complex and controversial. Including other factors in the mechanism would greatly increase its complexity and the potential for inappropriate adjustments to rates. (The complexity can be minimized only if full decoupling is implemented, which MGE does not recommend.)

6. If you answered yes to Question 5, should it be necessary for a utility to propose additional energy efficiency spending before it could seek recovery of any lost revenues due to other factors?

MGE Response: NA

7. If a decoupling mechanism considers only the effects of additional energy efficiency spending, but due to weather, economic, or other factors the overall sales are equal to or greater than forecast, or if due to other factors the utility is either earning its authorized ROE or is within some range of its authorized return, should it still recover lost revenues?

MGE Response: A decoupling mechanism should be designed to recover only lost revenues resulting from unforecasted drops in sales due to energy efficiency improvements by customers as a result of utility-sponsored programs (either utility run programs or Focus on Energy programs.). Neither the utility's earned, or authorized, ROE should be a factor in a decoupling mechanism.

One difficulty in designing a decoupling mechanism is highlighted in the response to No. 5 above. The question becomes: How could anyone calculating the revenue adjustment determine the degree to which sales were reduced by the program versus customers implementing conservation steps on their own? Because of this unknown, such mechanisms are subject to manipulation that will distort the intended result.

8. Please provide what you believe to be the key components of a decoupling mechanism.

MGE Response: A decoupling mechanism and how it operates: (1) must be transparent so that all parties can review all the calculations, (2) must be limited to adjustments for energy efficiency improvements, (3) should apply to all classes of customers, (4) should not include an earnings test, and (5) should be easy to administer.

9. **Please provide examples of ratemaking mechanisms other than decoupling that could incent utilities to pursue additional energy efficiency spending at a reasonable cost to ratepayers.**

MGE Response: MGE has not researched the question and therefore has no example(s) of mechanisms to offer. However, straight fixed/variable rate design would eliminate the disincentive for which decoupling is being considered.

10. **Should all customer classes be included in any mechanism that is implemented to encourage utilities to promote additional energy efficiency spending? Why or why not?**

MGE Response: All classes should be included because all classes can improve energy efficiency and should be encouraged to do so. If a decoupling mechanism is limited to one class, recovery of lost revenue or return of revenue should be limited to the class subject to decoupling.

11. **If your answer to Question 9 is no, should additional energy efficiency programs only be designed to benefit only participating customer classes? Why or why not?**

MGE Response: NA

12. **Do you foresee controversy in determining the amount of reduced kWh sales caused by additional energy efficiency spending and the dollar margin on the reduced sales used to determine the under recovered amount to be included in rates? Why or why not?**

MGE Response: Yes, this determination is likely to be controversial because it is difficult, if not impossible, to measure the effect additional energy efficiency spending has on sales, and results may be subject to wide variation depending on the methodology used. Disputed issues likely would expand when an increased number of factors are used in measurement.

13. **Considering the lag time between the design and implementation of energy efficiency programs and that utilities file regularly for rate reviews, would the following alternative to decoupling be useful in removing disincentives to utilities promoting these programs? For programs that a utility is proposing prior to a rate case filing, an estimate of reduced sales would be made and the test-year sales forecast would be reduced accordingly. For programs developed and implemented during the utility's biennial period, a decoupling mechanism could be used to adjust for the impact of these programs until the next rate period (it would be likely that the lag time in implementing programs would make revenue adjustments relatively small).**

MGE Response: The described alternative would protect the utility from lost revenues resulting from new programs initiated between rate adjustment periods. As long as any adjustments are limited to specifics of programs and are not modified for other extraneous factors such as ROE, it could be viewed as removing the disincentive for expanding efficiency programs. Whether or not it would provide incentives is unclear.

14. **Is revenue decoupling illegal retroactive ratemaking? Why or why not?**

MGE Response: There may be a whole range of potential decoupling mechanisms. Until the precise nature of a mechanism is specified, MGE is unable to comment on the extent to which it may be vulnerable to legal attack on grounds of illegal retroactive ratemaking or otherwise.

15. **Are you aware of mechanisms other states use to incent additional energy efficiency on behalf of their utilities that you believe would be successful in Wisconsin? If so, please identify those states?**

MGE Response: No

16. Does a decoupling mechanism represent a reduction in risk to the utility? If so, should that be reflected in the authorized return on equity?

MGE Response: No

17. What process should the Commission use to establish the parameters of ratemaking approaches that promote energy efficiency, i.e., should the Commission approve utility-specific plans or establish guidelines for implementation in rate cases?

MGE Response: The Commission could establish general statewide guidelines for potential implementation of a decoupling mechanism. However, the Commission should evaluate specific decoupling mechanisms on a utility specific basis. Implementation should be on a case-by-case basis for each utility and not established as a statewide requirement.

18. Are there important differences between gas and electric utilities to be considered when designing an incentive mechanism?

MGE Response: Yes. Actual gas sales volumes are dramatically affected by weather, when compared to electric sales volumes, because of the dominance of gas heating load. Furthermore, about 70 percent of gas utility revenues are already subject to a decoupling mechanism of sorts. The purchased gas adjustment clause and its associated true-up provisions provide a match of revenues and commodity expenses to sales volume variances.